

March 8, 2004

Ms. Jennifer J. Johnson  
Secretary, Board of Governors of the Federal Reserve System  
20<sup>th</sup> Street and Constitution Avenue, N.W.  
Washington, D.C. 20551  
VIA E-MAIL [regs.comments@federalreserve.gov](mailto:regs.comments@federalreserve.gov)

Re: R-1176

Dear Ms. Johnson:

Thank you for the opportunity to comment on proposed amendments to Regulation CC, that would add a new subpart D, to implement the recently-enacted Check Clearing for the 21<sup>st</sup> Century Act (Check 21). The New York Bankers Association (NYBA) supported the enactment of Check 21, as an important step to the facilitation of electronic check processing and consequently, generally supports the proposed amendments to Regulation CC. Our letter, however, is limited to one specific element of the proposal – that is, the proposed requirement to encode substitute checks in MICR ink. We are seeking an exception to that requirement, designed to ensure that a substitute check would not lose its status as the legal equivalent of the original check if the MICR information is not encoded in magnetic ink under certain specifically delineated circumstances. Such an exception would address a problem that is unique to New York and Massachusetts alone, where state law requires that banks must offer a consumer account where the paid original checks are returned with the customer's statement. NYBA is comprised of community, regional and money center commercial banks in State of New York, including approximately 55% state-chartered banks and 45% national banks, which in the aggregate have over 200,000 employees and assets in excess of \$1 trillion.

Continued

Ms. Jennifer J. Johnson  
March 8, 2004  
Page Two

### **MICR Line Information Not Encoded in Magnetic Ink**

We respectfully request that the final rule include a new provision that expressly authorizes a paying bank to create a substitute check without printing the MICR line information in MICR ink under the following circumstances: (i) the paying bank has paid the check based upon its electronic presentment; (ii) the paying bank has created the substitute check solely to return it to its customers with the customer's periodic statement; (iii) the information from the original checks MICR line appears on the substitute in non-MICR ink; and (iv) the reconverting bank is subject to the warranties and indemnification in Sections 229.52-53. This would significantly reduce a problem that exists under New York Banking Law, as section 9-m requires a bank to offer a consumer customer an account where the paid original check must be returned with the customer's statement. (Massachusetts law has a similar requirement).

Under the current proposal, a substitute check that is not encoded in MICR ink would be a "purported" substitute check. This would not be the legal equivalent of the original check, but the reconverting bank would still be subject to the warranties and indemnification in Sections 229.52-53, as if it were a substitute check. To avoid this result, a bank returning a check to a customer with a 9-m account would have to MICR-encode the check, thereby creating a legal equivalent of the original check. As it may be impossible or impracticable for a bank to differentiate between 9-m and non 9-m accounts, this may force a paying/reconverting bank to MICR-encode all substitute checks that it returns to its consumer customers – an expensive and operationally inefficient outcome. Even if a bank could identify a 9-m account, we do not believe that there would be any benefit to the consumer, which would justify the additional cost involved in encoding the check in MICR ink.

We do not believe that receiving a paid substitute check that is not MICR-encoded would disadvantage a customer, as customers do not use MICR line readers, and can visually read all the information on the substitute check. Thus, the substitute check should be acceptable as a proof of payment. Moreover, as the check, which has been paid, will not be reintroduced into the check collection system, either on a forward collection or return basis, MICR-encoding will not be needed for processing purposes. Therefore, eliminating the MICR-encoding requirement in these circumstances should enhance the efficiency of bank processes without harming any customers. Additionally, the elimination of this

Continued

Ms. Jennifer J. Johnson  
March 8, 2004  
Page Three

requirement may induce more banks to enter into arrangements with other banks to exchange just check image files, instead of exchanging a mix of paper checks and check images, allowing banks to image a greater number of checks much earlier in the check collection process.

For all the reasons set forth above, we urge that the proposal be amended to eliminate the MICR-encoding requirement under the narrow circumstances, which we have outlined in this letter. Once again, we thank you for the opportunity to comment on this issue.

Sincerely,

Michael P. Smith